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C O N F I D E N T I A L SECTION 01 OF 02 SAO PAULO 000335

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TAGS: ECON ENRG EPET PGOV EINV EAGR BR
SUBJECT: AMBASSADOR DISCUSSES BRAZILIAN OIL CONCESSION MODEL WITH DELFIM NETTO

REF: A. RIO DE JANEIRO 138 B. RIO DE JANEIRO 135 C. 07 SAO PAULO 953 D. SAO PAULO 247

Classified By: Consul General Thomas White; reasons 1.4 (b) and (d).

¶1. (C) SUMMARY: During a June 13 meeting with the Ambassador, former Minister of Finance Antonio Delfim Netto (strictly protect), who is currently working as a political and business consultant and widely believed to be an unofficial advisor to President Lula, discussed his views on Brazil's newfound oil reserves. Delfim Netto did not see any strong desire on the part of the GOB to nationalize existing fields or to substantially change the rules governing concessions (Ref A). Instead, Delfim Netto indicated that the GOB would support a continuation of the concession framework but indicated that royalties would increase. He stated that the GOB (through the National Energy Petroleum Council) would maintain existing royalty agreements for all fields currently under production, and that the National Petroleum Agency (ANP) would open bidding for the exploration rights on the new reserves to foreign competition. Delfim Netto told the Ambassador that foreign investment would be necessary to finance development of these reservoirs to ensure near term production. END SUMMARY.

¶2. (C) In a meeting on June 13 with the Ambassador, Delfim Netto said that the GOB and Petrobras do not share the same goals for developing reserves from the newfound deep-water petroleum discoveries. Many energy insiders believe Petrobras is stalling the bidding process in order to pull together the financial resources to win concessions for many of the pre-salt oil blocks that had been removed from the ninth round of oil block auctions in November 2007 (Refs B and C). (Note: Petrobras was privatized in 1997 and 63 percent of the company is now publicly traded on the NYSE and Bovespa. End Note.) Delfim Netto confirmed that the GOB wanted to move forward on the exploration of these reserves and that its goals and those of Petrobras have diverged.

¶3. (C) Despite the public rumors regarding changes to and potential abolishment of the concession model, Delfim Netto

told the Ambassador that Brazil would keep the same concession model, but could increase the percent of royalties charged for the new reserves (Ref A); with which he agreed. He added that he supported charging Petrobras royalties. He told the Ambassador that he promoted the idea that Petrobras open up the energy market and that the GOB realizes it would be a necessary condition to finance the exploration of the new reserves.

¶4. (C) Likewise, Delfim Netto acknowledged that Petrobras was also a potential obstacle on biofuels issues. Given the inherent conflict of interest for Petrobras to manage bio-fuels initiatives, Delfim Netto told the Ambassador that Petrobras should and would be "removed from the equation." When asked if the GOB would support a spin-off of the Biofuels Unit within Petrobras, Delfim Netto thought it was assured.

¶5. (C) At the Ambassador's suggestion of high-level meetings between the two governments, Delfim Netto said he estimated that it would take 30 to 60 days for the GOB to solidify a new concession and royalty framework, and that after that point he believed USG engagement would be welcome.

¶6. (C) COMMENT: Delfim Netto's analysis of the divergence of interests between Petrobras and the GOB bears watching. Given the recent negative history of Bolivia's privatizations, it seems unlikely that the GOB would abandon the concession model and even more unlikely that it would choose to change the rules on existing concessions. Political and economic stability have been the cornerstones of Brazil's policies and largely led to Brazil obtaining investment grade status (Ref D). While some modification of exploration and concession rules may take place for these new "mega fields", it is doubtful the GOB would do anything to undermine the overall image of Brazil as a stable country in which to invest.

¶7. (C) Unlike Delfim Netto's view that the USG should hold off on intervening to establish these new rules, Brazil's Ministry of Mines and Energy, regulators, and US energy companies have suggested that it could instead be within this period for the USG to intervene. Indeed, Petrobras' interest in consolidating deep-sea drilling in the Gulf of Mexico and vertical integration in the US market could open an important window of opportunity for the USG. Furthermore, ANP has expressed interest in learning more about US small and medium sized energy companies operating in US states to develop a similar capacity in Brazil. They have, in fact, asked for USG assistance to travel to the US to meet with and further learn about this important part of the energy equation. Clearly, Brazil's energy sector offers new partnerships, opportunities, and increased energy security for the US. As Brazil begins to increase exploration of its newfound "pre-salt" reserves that many believe could be larger than the finds in the North Sea, the US could potentially capitalize on these new technologies to develop our own offshore exploration efforts. Early engagement may be crucial to ensuring that US firms will have opportunities in this market. END COMMENT.

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